Social Security Overview

Why Social Security Is Important
The Challenges It Faces

Social Security is Important

Social Security is the **single largest source of retirement income in the U.S.** For 6 in 10 seniors, Social Security provides half or more of their total income. Among elderly widows, Social Security provides nearly three-quarters of their income, on average. And 4 in 10 widows rely on Social Security to provide 90 percent or more of their income.

Social Security benefits are modest. For a worker with average earnings, Social Security benefits will replace about 42% of pre-retirement earnings. The table below shows average benefit amounts for people on the rolls today.

Average Social Security Benefits, 2005

	Monthly Benefit	Annual Benefit
Retiree	$955	$11,460
Retiree and spouse	$1,574	$18,888
Aged widow	$920	$11,040
Disabled worker & family	$1,497	$17,964

But Social Security is **more than just retirement income**. About 30 percent of Social Security beneficiaries receive disability or survivor benefits. For a 27-year-old worker with a spouse and two children, Social Security provides the equivalent of a $403,000 life insurance policy or a $353,000 disability insurance policy. The vast majority of workers would be unable to obtain similar coverage through private markets.

Social Security is also **family insurance** -- it provides benefits for elderly widows, and young parents who have lost a spouse. It provides dependable monthly income to children who have lost a parent to death or disability. It even pays benefits to those who became severely disabled as children, and remain dependent as adults on a parent who receives Social Security.

Finally, Social Security benefits are calculated under a **progressive benefit formula**. It provides a higher benefit, relative to earnings, for a low-wage worker than a higher-wage worker. Social Security recognizes that higher-income workers have more opportunity to save or earn a pension than lower earners, and lower earners will need to depend more heavily on Social Security.

Social Security is Successful

Social Security is the **single most effective anti-poverty program there is.** Its benefits lift nearly 12 million seniors out of poverty. Thanks to Social Security, the poverty rate of elderly persons is only 8 percent. Without it, nearly half of retirees would live in poverty.

When Social Security began, it covered only a fraction of the workforce, and provided benefits only to retired workers. Today, it insures 96 percent of all workers -- and their spouses and children -- against the loss of income due to retirement, death or disability.

Today, about 48 million people receive monthly benefits from Social Security, or **1 out of every 4 households**. Over 90 percent of seniors receive Social Security benefits.

Over the course of its 69-year history, Congress has prudently managed the Social Security program. Each year, the Social Security Board of Trustees issues a report showing short-range and long-range (75-year) projections of the income and costs of the system. Congress uses these projections to balance the promise to pay future benefits against workers' desire and ability to pay for them. And it has adjusted the program periodically in light of changing economic and demographic conditions.

Finally, Social Security is **administered very efficiently**. Only one penny of every dollar Social Security spends is for administration. The rest goes directly to beneficiaries in their monthly checks.

Social Security's Unique Value

Social Security is the only universal, portable, defined-benefit pension system for American workers.

Social Security is nearly **universal**. Over 95 percent of all workers are covered by it. In contrast, less than 50 percent of workers have employer pension coverage on their job.

Social Security is **totally portable** -- it goes with a worker from job to job. Traditional private-sector pension plans lose value when a worker changes jobs.

Social Security is a **"defined benefit**" pension system. That is, its benefit are determined according to the level of a worker's earnings and years of work. This type of pension system provides income continuity in retirement by replacing a fixed percentage of a worker's pre-retirement earnings. **Benefits are paid as long as the worker (and his or her spouse) lives, and the monthly benefit amount is predictable and steady.**

In contrast, a "defined contribution" system (such as a 401(k) or an individual savings account) can pay out only what is in the account. If a worker did not contribute in certain years, or has poor investment results or just the misfortune of retiring in a down market, he must get along on less. If the account is exhausted before a worker reaches the end of her life, she will have nothing left to live on. Defined contribution plans are an excellent supplement to defined benefits for retirement, but they cannot replace them.

Finally, Social Security is based on the concept of **insurance**: it pays benefits whenever an insured-against event happens. It protects against the risk of having low income in old age. It protects against the economic risk of career-ending disability or premature death. It insures family members against the loss of a breadwinner's earnings. And **it spreads risk broadly throughout society, to lower the cost of these protections and to make them affordable for all.**

Challenges Facing Social Security

Social Security today runs an annual surplus. The revenues received by the Trust Funds from taxes and interest on its reserves is larger than the annual benefit costs. According to the Congressional Budget Office (CBO), Social Security is projected to run surpluses for about the next three decades, until 2033.

In the long term, however, there is an imbalance between projected revenues and projected benefit costs. Starting in about 2033, Social Security will begin redeeming the Treasury bonds held in its reserves. It will continue doing so until about 2052. At that point, current revenues coming into the Trust Funds will cover about 80 percent of current benefits.

Social Security is projected to cost more in the future largely because the number of Americans over 65 will grow faster than the number of workers. This occurs for three reasons: the baby boomers will begin to reach 65 in 2011, people are living longer after 65, and birthrates are assumed to remain historically low. While costs are projected to rise, the tax rate is constant under current law.

How big is the problem?

Both CBO and the Social Security Administration (SSA) actuaries make long-term projections of Social Security's financial condition. According to CBO, the long-range deficit is equal to 1.00 percent of wages that are subject to Social Security taxes. That is, raising Social Security's revenues, or cutting its benefits, in an amount that would equal 1.00 percent of wages would close the gap. SSA actuaries, using more conservative assumptions, estimate the gap at 1.89 percent of wages.

There are several ways to **put this cost into perspective:**

- **The long term cost of the Administration's tax policies are 3 to 5 times as large as the cost of eliminating the gap in Social Security's long-term finances.** The cost of filling Social Security's gap is between 0.4 percent and 0.7 percent of GDP, while the cost of the Administration's tax cut is *2 percent of GDP*. (Center on Budget and Policy Priorities) In fact, **the tax cuts for just the 1 percent of households with the highest incomes exceed the entire Social Security shortfall** projected by CBO.

- **When the baby boomers are retired, the total number of people supported by each**

worker will not be as large as when the baby boomers were children. In 1960, each worker supported 2.62 people (including the worker him- or herself, children, retirees and non-workers.) In 2030, each worker is projected to support 2.21 people. And as a share of the total economy, the rise in Social Security costs during the baby boom's retirement will not be as large as the rise in spending for public education when the baby boomers were children. (National Academy of Social Insurance)

One way or the other, retirees will be supported by our economy. The retirees of the future are alive today – their needs will not simply go away. The workers of the future will have to produce the goods and service that the elderly of the future will consume. **Shifting the burden of financing retirement onto individuals or their families will not reduce the cost of their consumption in retirement. It just changes who will pay for it and how the risks are borne**.

Is privatization a solution to Social Security's challenges?

Setting up private accounts is sometimes suggested as a way to avoid the difficult choices involved in restoring long-term balance to Social Security. However, the President's own Social Security commission has demonstrated that this is not the case. **The commission's privatization plan makes deep cuts in Social Security benefits and worsens the financing shortfall in Social Security.**

This is because Social Security is financed essentially on a "pay-as-you-go" basis. Its tax rate is set just high enough to pay for current benefits. Most of the money coming into the Trust Funds is used immediately to pay for benefits. (Any surpluses are invested in interest-earning Treasury bonds, which will be redeemed in the future to supplement payroll tax revenues when the baby boomers retire.)

Diverting some of the Trust Funds' revenues to fund individual accounts – even an amount as little as 2 percent of wages – will create a shortfall in the Social Security Trust Funds. This is why **privatization plans inevitably include substantial cuts in Social Security benefits**. They also require tax increases or subsidies from the rest of the federal budget – or explode the national debt. For example, the main plan developed by the President's privatization commission:

- **Drains \$2.2 trillion** out of the Social Security Trust Funds in just the next 10 years.

- **Cuts Social Security benefits by up to 46 percent** for future retirees.

- **Explodes the national debt**, making the debt **higher for nearly 60 years**. It would create new debt (on top of that projected under current law) equal to 24 percent of GDP.